1H 2018 Financial Results

2 August 2018

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1. 1H2018 highlights

This is Íslandsbanki

Íslandsbanki

A leader in financial services in Iceland, Íslandsbanki is a universal bank with a proven strategy

Leading the **Icelandic Customer Satisfaction Index** for **5** consecutive years

The Banker

Bank of the year in Iceland 2014, 2016, 2017

EUROMONEY AWARDS FOR EXCELLENCE

2013-2016, 2018

Driven by the **vision to be #1 for service**, our relationship banking business model is propelled by three business divisions that manage and build relationships with our customers. A clear focus is on growth, simplifying our operations and unify our objectives with society - or as we like to say it - we **MULTIPLY**, **SIMPLIFY** and **UNIFY**

1H18 Key figures

ROE (Regular operations)[1]	9.9%
Leverage Ratio	14.5%
Total Capital Ratio	21.6%
Total Assets	ISK 1,112bn / EUR 8.9bn

Employees

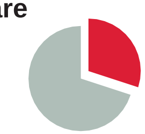
826

Number of FTE's for parent company at end 1H2018

91% **Job satisfaction** among Íslandsbanki's employees

4 training courses a year per **employee**

Market share



Individuals **32%**

SMEs **36%**

Large companies **32%**

Ways to bank

74,000 APP users

1 Self-service branch

14 Branches

56 ATMs

Users **111,000** **online** banking

Credit ratings

BBB+/A-2

S&P Global Ratings

Stable outlook

BBB/F3

FitchRatings

Stable outlook

Personal Banking

Provides customers with comprehensive banking services through digital channels and a modern nationwide branch network.

FOR INDIVIDUALS

Business Banking

Responsible for service to SMEs in the Bank's branches, as well as Ergo, Íslandsbanki's asset based financing unit.

FOR SMEs

Corporate and Investment Banking

Provides comprehensive financial services to investors and large companies, including lending, securities and currency brokerage, corporate advisory services, private banking services, and sales of hedging instruments.

FOR LARGE COMPANIES AND INVESTORS

1. Return from regular operations and corresponding ratios on normalized CET1 of 15%, adjusted for risk free interest on excess capital. From January 2018 the definition of regular operations has been revised to include profit from discontinued operations as the Bank has successfully divested all non-core business related assets

Operational highlights

Eventful first half of 2018 for Íslandsbanki

Íslandsbanki

2018

JANUARY

- New **Kreditkort app** launched
- Íslandsbanki **leads customer satisfaction index** in 2017 for 5th consecutive year
- **EUR 300m 6NC5 year bond issued** at 75 basis points over 5 year mid-swaps

FEBRUARY

- **Increased savings** during Bank's ad campaign in relation to Champions Month
- **Over 4,500 overdraft applications approved** by end February through new automated online service
- IS Funds announces the launch of **new housing project, 105 Miðborg**, at Íslandsbanki's old HQ location, Kirkjusandur
- Fríða **loyalty programme launched** in Íslandsbanki app
- Overdraft applications in Íslandsbanki's app **automatised**
- Bank's **gender equality policy revised** - #metoo lunches & barbershops organised with employees

MARCH

- AGM approves **ISK13bn dividend payment**
- **Corporate finance completed multiple projects** in Q1, including bond issues for HS Veitur, Byggðastofnun and Garðabær municipality
- **Good growth in mortgage loans** with new mortgages 5% higher than during same period in 2017
- New **tourism report** published

APRIL

- **Direct deposits** via the Íslandsbanki app to Kreditkort issued credit cards
- **Automated** online **credit score** and **automated secure transfers of documents** to real estate brokers
- The Bank is selected to manage the **sale of shares in Jarðboranir**
- The Bank issues a **SEK 1billion callable 4 year bond** (4NC3); spread Stibor+80bp.
- **Open banking** strategy announced by the Bank

MAY

- Íslandsbanki advises **Heimavellir hf.** on its Nasdaq listing
- **Branch at Selfoss** renovated with increased emphasis on automaton
- **Ground broken** on new business and residential area next to where Íslandsbanki's HQ were located – **105 Miðborg**
- New **Economic forecast for Iceland** published
- Íslandsbanki **manages** on behalf of Brim a **takeover bid** to shareholders of HB Grandi hf.

JUNE

- The Bank **leads a consortium for** EUR 190m **syndicated loan** to HB Grandi
- New report issued on the finances of the **2018 World Cup in Russia**
- New report issued on **Icelandic municipalities**
- Ergo – **digital signature** made available for signing contracts
- Íslandsbanki **supports** the Red Cross initiative **Digital Divide** Initiative in Africa
- Euromoney names Íslandsbanki as **Iceland's best bank** (July)
- S&P Global Ratings **affirms Íslandsbanki rating** of BBB+/A-2 rating with stable outlook (July)

Q3

Q1

Q2

Financial highlights

Key figures & ratios

		1H18	1H17	2Q18	2Q17	2017
PROFITABILITY	ROE 15% CET1 (regular operations)[1]	**9.9%**	11.2%	**11.6%**	11.8%	10.3%
	ROE (after tax)	**8.2%**	9.2%	**11.6%**	11.3%	7.5%
	Net interest margin (of total assets)	**2.8%**	2.9%	**2.8%**	3.0%	2.9%
	Cost to income ratio[2]	**67.3%**	59.2%	**65.0%**	58.3%	62.5%
	After tax profit, ISK m	**7,130**	8,041	**5,033**	4,997	13,226
	Earnings from regular operations, ISK m[3]	**6,842**	7,365	**3,961**	3,860	13,848

		30.6.2018	31.3.2018	31.12.2017
CAPITAL	Total equity, ISK m	**172,182**	166,337	181,045
	Tier 1 capital ratio	**20.5%**	20.3%	22.6%
	Total capital ratio	**21.6%**	21.4%	24.1%
	Leverage ratio	**14.5%**	14.3%	16.2%
BALANCE SHEET	Total assets, ISK m	**1,111,742**	1,088,308	1,035,822
	Risk exposure amount, ISK m	**819,349**	795,923	775,492
	Loans to customers, ISK m	**799,938**	776,149	755,175
	Total loans, ISK m	**859,796**	823,369	781,792
	Total deposits, ISK m	**593,805**	588,759	578,218
	Total deposit / loan ratio	**69.1%**	71.5%	74.0%

1. Return from regular operations on normalised CET1 of 15%, adjusted for risk free interest on excess capital. From January 2018 the definition of regular operations has been revised to include profit from discontinued operations as the Bank has successfully divested most non-core business related assets
2. Calculated as (Administrative expenses + Contribution to the Depositors' and Investors' Guarantee Fund – One off items) / (Total operating income – one off items)
3. Earnings from regular operations is defined as earnings excluding one-off items e.g. bank tax, one-off costs due to headquarters and the impairment of goodwill

- Íslandsbanki proud sponsor since 1997
- ISK 660m for charities raised since 2016 (record ISK 118m in 2017)
- Over 160 charities are beneficiaries
- This year a group of Iceland's top actors teamed up with the Bank in an ad campaign for the event
- The actors donated all their work for charity through the Bank
- The ad campaign has been a huge success in Iceland and has received substantive international coverage

2. Income statement

Income statement

Positive net impairment has a substantial impact on net earnings

ISK m	1H18	1H17	Δ	2Q18	2Q17	Δ
Net interest income	**15,342**	15,211	132	**7,602**	7,814	(212)
Net fee and commission income	**5,810**	6,813	(1,003)	**3,032**	3,543	(511)
Net financial income	**95**	109	(14)	**378**	97	(281)
Net foreign exchange gain	**(67)**	370	(437)	**(57)**	169	(226)
Other operating income	**1,600**	215	1,385	**1,587**	55	1,532
Total operating income	**22,780**	22,718	62	**12,542**	11,678	864
Salaries and related expenses	**(7,952)**	(7,768)	(184)	**(4,026)**	(4,109)	83
Other operating expenses	**(5,770)**	(5,498)	(272)	**(2,846)**	(2,739)	(107)
Administrative expenses	**(13,722)**	(13,266)	(456)	**(6,872)**	(6,848)	(24)
Depositors'and Investors' Guarantee Fund	**(579)**	(515)	(64)	**(287)**	(262)	(25)
Bank Tax	**(1,597)**	(1,472)	(125)	**(812)**	(752)	(60)
Total operating expenses	**(15,898)**	(15,253)	(645)	**(7,971)**	(7,862)	(109)
Profit before net impairment on financial assets	**6,882**	7,465	(583)	**4,571**	3,816	755
Net impairment on financial assets	**1,934**	440	1,494	**1,846**	200	1,646
Profit before tax	**8,816**	7,905	911	**6,417**	4,016	2,401
Income tax expense	**(2,480)**	(2,263)	(217)	**(1,465)**	(1,133)	(332)
Profit for the period from continuing operations	**6,336**	5,642	694	**4,952**	2,883	2,069
Profit from discontinued ops. net of income tax	**794**	2,399	(1,605)	**81**	2,114	(2,033)
Net profit	**7,130**	8,041	(911)	**5,033**	4,997	36

HIGHLIGHTS

- Total income amounted to ISK 22.8bn in 1H18, an increase of 0.3% between years as a result of strong interest income and the sale of properties
- Net interest income totalled ISK 15.3bn, an increase of 0.9% from the previous year
- The net interest margin was 2.8%, which is 10 basis points below 1H17
- Overall net fee income showed a 15% decline year on year, principally due to lower activity levels from two of the Bank's fee generating subsidiaries
- Net impairment on financial assets generated a gain of ISK 1.9bn in 1H18, compared to ISK 0.4bn gain in 1H17, mostly deriving from the lifting of the Bank's prior commitments in relation to foreign currency-based loans

Operating income

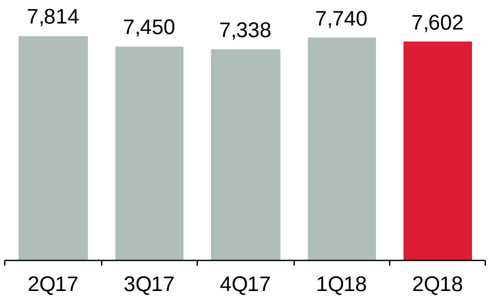
Core earnings continue to form basis of total income

INCOME TRENDS

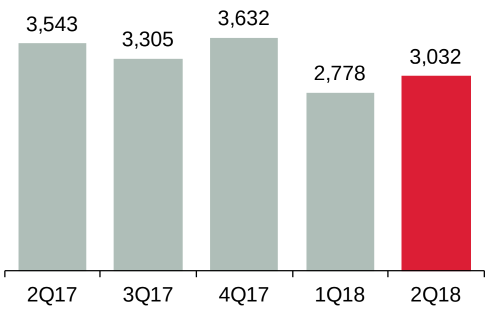
TOTAL OPERATING INCOME
Excluding one-off income
ISKm

REVENUES AT SIMILAR LEVELS WITH PREVIOUS PERIODS

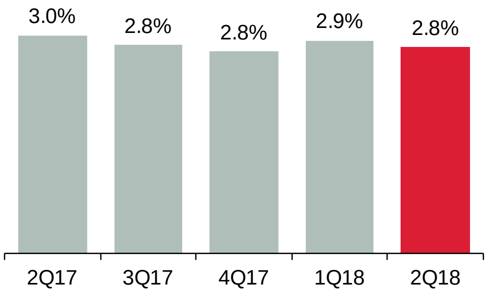
NET INTEREST INCOME (NII)
ISKm



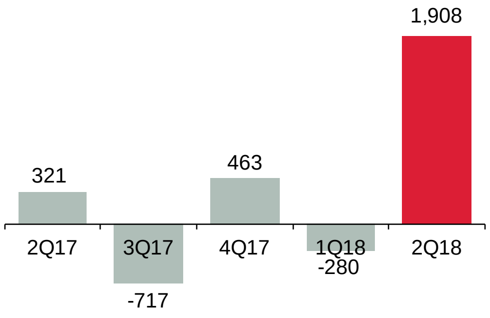
NET FEE AND COMMISSION INCOME
ISKm



NET INTEREST MARGIN (NIM)
%



OTHER INCOME
ISKm



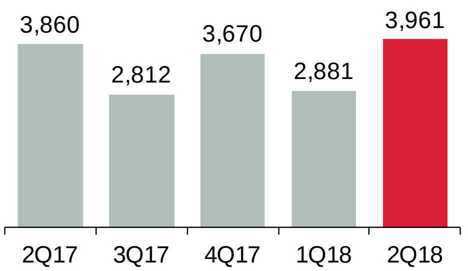
Earnings from regular operations

Excludes one-off items and ROE calculation is adjusted to normalised CET1 of 15%

RESILIENT ROE FROM REGULAR OPERATIONS

ISKm	1H18	1H17	Δ	2Q18	2Q17	Δ
Reported after tax profit	**7,130**	8,041	(911)	5,033	4,997	36
One-off revenue	**(2,546)**	0	(2,546)	(2,546)	0	(2,546)
One-off costs[1]	**0**	340	(340)	0	304	(304)
Bank tax	**1,597**	1,472	125	812	752	60
Profit (loss) from discontinued ops	**0**	(2,399)	2,399	0	(2,114)	2,114
Tax impact of adjustments	**662**	(89)	751	662	(79)	741
Earnings from regular operations[2]	**6,843**	7,365	(522)	3,961	3,860	101
ROE 15% CET1 (regular operations)[3]	***9.9%***	*11.2%*		*11.6%*	*11.8%*	
ROA from regular operations (after tax)	***1.3%***	*1.4%*		*1.4%*	*1.5%*	
Net interest margin adj. 15% CET1	***2.7%***	*2.7%*		*2.6%*	*2.8%*	
Cost / income ratio adj. 15% CET1	***70.6%***	*63.3%*		*59.3%*	*61.9%*	

EARNINGS FROM REG.OPERATIONS
ISK m



Earnings from regular operations

- The definition has now been reviewed and from 1Q18 will exclude profit from discontinued operations as the Bank has successfully divested most non-core business-related assets
- Had profit from discontinued operations been included the profit from regular operations would total ISK 5,321m, providing a ROE 15% CET1 of 8.6%

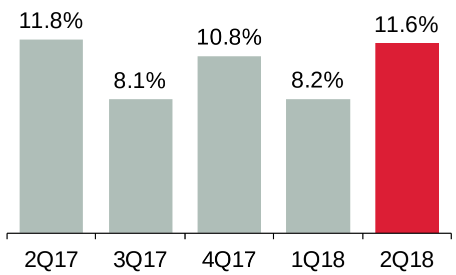
One off items 2018

- ISK 1.5bn in income from the sale of property in April deemed one-off income and ISK 1.0bn as the statute of limitation for some disputed foreign currency-linked loan contracts passed
- ISK 340m in one-off costs in 2017 are a result of ombudsman extra charges

Earnings from regular operations

- Regular earnings decreases, as a result of underperformance from two of the Bank's fee generating subsidiaries

ROE REG. OPERATIONS CET1 15%
%



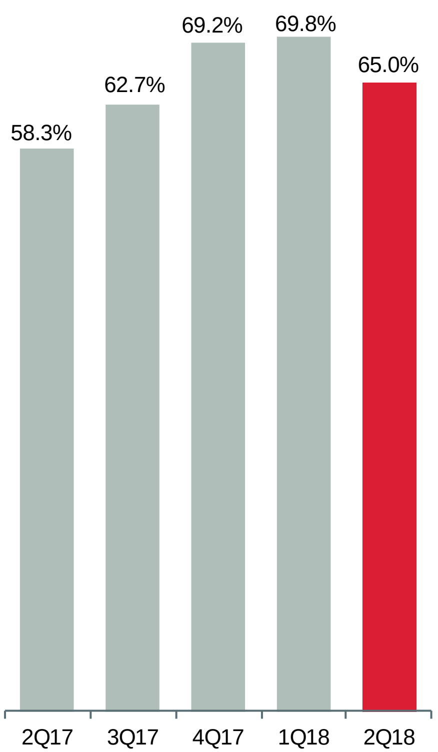
1. One-off costs include the impact of organisational changes, extra ombudsman charges and expenses related to the old headquarters
2. Earnings from regular operations is defined as earnings excluding one-off items e.g. bank tax, one-off costs due to headquarters.
3. Return from regular operations and corresponding ratios on normalized CET1 of 15%, adjusted for risk free interest on excess capital

Administrative expenses

Administrative expenses, excluding one-off expenses, are at comparable levels to previous year

EFFICIENCY

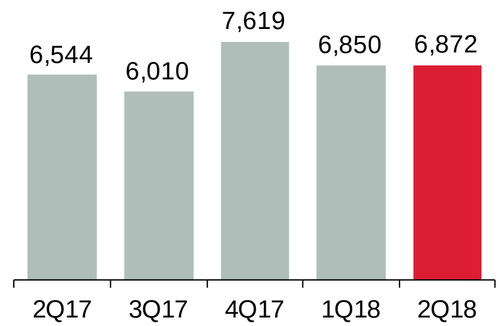
COST INCOME RATIO[1]
%



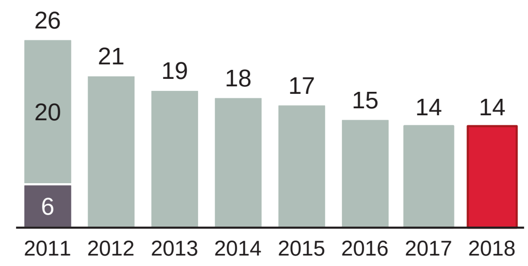
COST STRUCTURE IMPROVING OVERALL

ADMINISTRATIVE EXPENSES[2]
ISK m

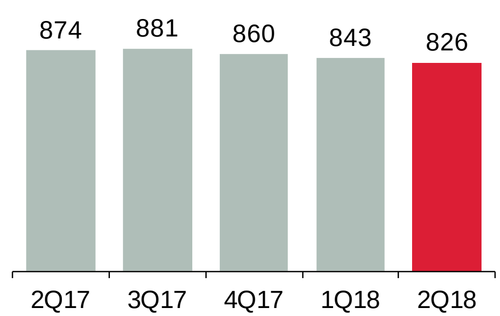
Real change in administrative expenses
from 1H17 to 1H18: +3.6%



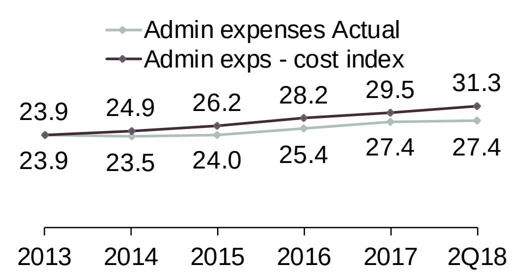
BRANCH NETWORK
#, Byr branches due to merger in dark grey



PERIOD END FTE NUMBERS[3]
#, Parent company



ANNUALISED ADMIN.EXPENSE vs COST INDEX[4]
ISK bn, excl. one-off cost, parent company



1. The cost-to-income ratio excludes Bank tax and one-off cost and revenue items

2. Excluding one off items
3. FTE numbers exclude summer employees
4. Administrative expense - cost index is calculated as 40% inflation and 60% salary index excluding one-off items

3. Balance sheet

Assets

Total assets are 7.3% up from year-end 2017

ISK m	30.6.2018	31.3.2018	31.12.2017
Cash and balances with CB	**166,194**	177,029	189,045
Bonds and debt instruments	**48,603**	49,140	27,090
Shares and equity instruments	**13,581**	10,208	10,177
Derivatives	**3,209**	4,673	2,896
Loans to credit institutions	**59,858**	47,220	26,617
Loans to customers	**799,938**	776,149	755,175
Investment in associates	**614**	672	704
Property and equipment	**5,058**	7,025	7,128
Intangible assets	**4,774**	4,412	4,231
Other assets	**8,512**	10,732	9,993
Non-current assets held for sale	**1,401**	1,048	2,766
Total assets	**1,111,742**	1,088,308	1,035,822

HIGHLIGHTS

Liquid assets

- Three line items – cash and balances with the Central Bank, bonds and debt instruments, and loans to credit institutions – amount to about ISK 275bn, some ISK 244bn of which are liquid assets

Loans to customers

- New lending amounted to ISK 98.5bn since year-end 2017
- Loans to customers grew by 5.9% since year-end

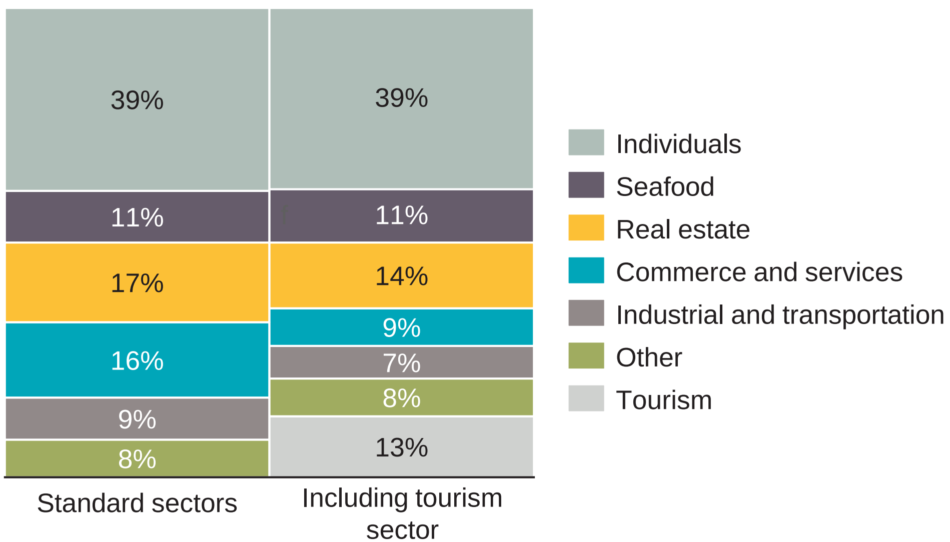
Asset encumbrance

- The Bank's asset encumbrance ratio was 16.5% at quarter end, compared to 15.8% at end March 2018

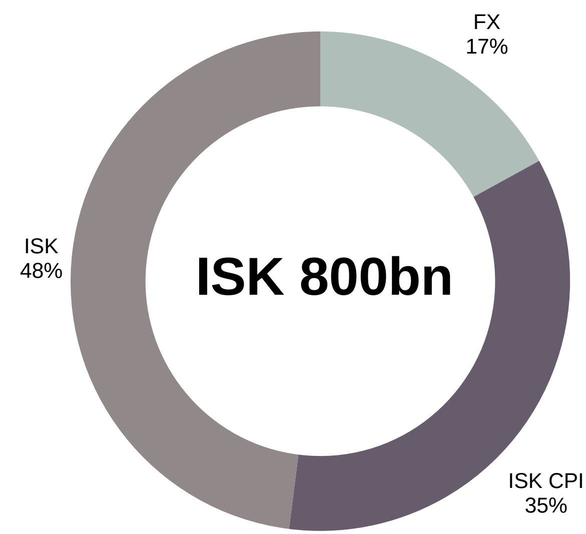
Diversified loan portfolio

Loans to customers increased by 5.9% in the first half of 2018, growth coming from all lending units

LOANS TO CUSTOMERS
by sector, consolidated



LOANS TO CUSTOMERS
by currency, consolidated



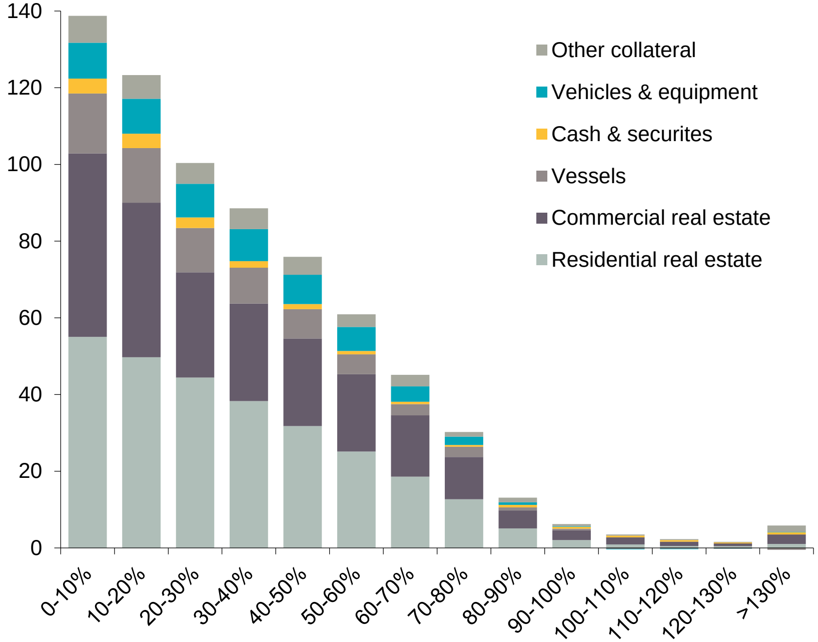
HIGHLIGHTS

- Demand for new credit came from all lending units of the Bank
- The mortgage portfolio increased by 4.6% during the first half of 2018
- Outstanding loans to the tourism industry are 13%, unchanged from year-end 2017. Real estate (hotels), commerce & services (car rentals, restaurants, tour operators) and industrials & transportation are the largest underlying sectors (airport services)

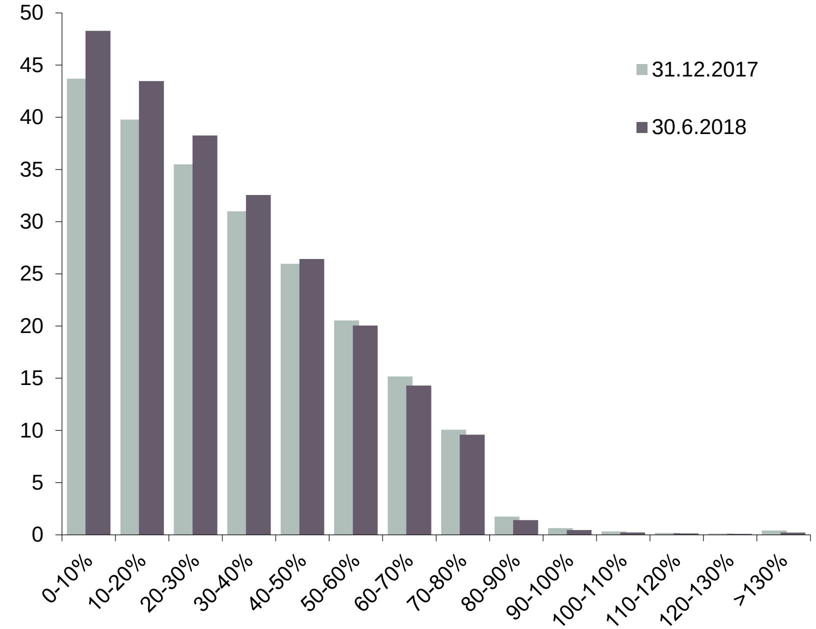
LTV distribution of loan portfolio

Loans generally well covered by stable collateral, majority in residential and commercial real estate

LTV DISTRIBUTION BY UNDERLYING ASSET CLASS
ISK bn, by type of underlying asset, as of 30.06.2018



CONTINUOUS LTV DISTRIBUTION OF MORTGAGES TO INDIVIDUALS
ISK bn, as of 30.06.2018 – average LTV 61% (63% 31.12.2017)[1]



HIGHLIGHTS

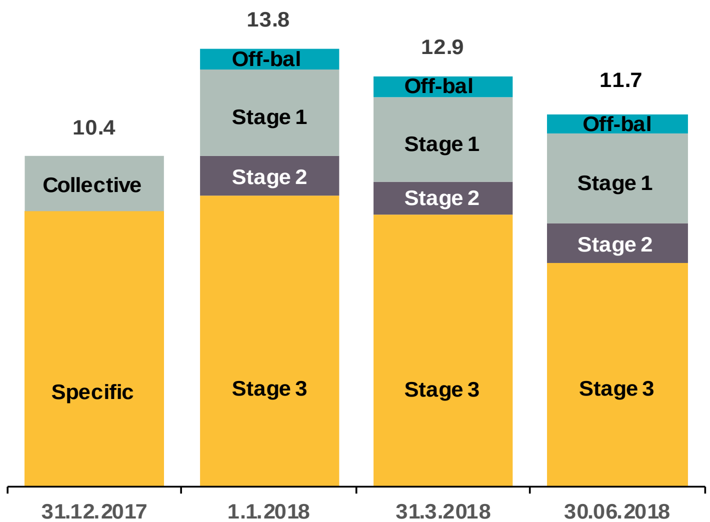
- Most of the Bank's collateral is in the form of residential and commercial real estate
- The second most important collateral type is vessels, mostly fishing vessels
- For seasoned mortgages, the LTV distribution is calculated from tax value of properties, which is published annually in June, but for newly granted mortgages the purchase price of the property can be used as a valuation in the beginning while it is considered more accurate
- LTV has decreased since year end 2017 which is mainly due to the newly published tax value of properties that raised housing valuations around 12.8% from its previous publication

1. The average LTV can be calculated in many different ways and therefore the definition is important for comparison to other banks. The weight is Íslandsbanki's total amount outstanding on the property and the LTV used is the maximum LTV of all Íslandsbanki's loans of the property.

Asset quality

Asset quality measurements changed due to implementation of IFRS 9

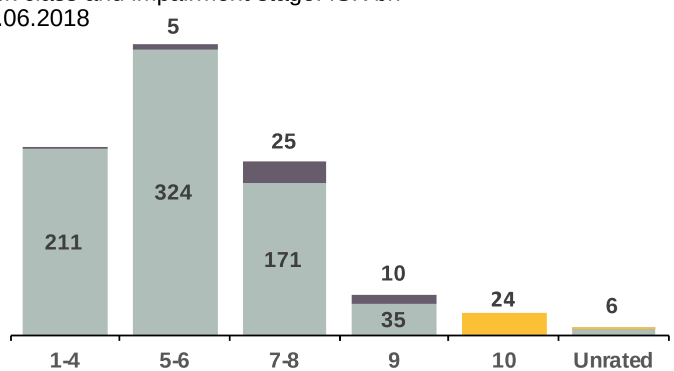
LOANS TO CUSTOMERS: IMPAIRMENT ALLOWANCE ACCOUNT [1]
Development of allowance account. ISK bn



HIGHLIGHTS

- With the adoption of IFRS 9, facilities are now categorised in one of three stages and receive an impairment accordingly. Consequently, specific and collective impairments are no longer reported
- In addition off-balance sheet exposures now contribute to the impairment allowance account
- The adoption of IFRS 9 also means non-performing ratios are no longer comparable over time, since all loans now carry an impairment allowance
- During 1H18 the impairment allowance decreased, mainly due to write-offs of facilities in Stage 3
- At the end of 1H18, gross carrying amount of loans in Stage 3 as a proportion of the total gross carrying amount of loans to customers was 2.9%
- Using the European Banking Authority's definition of NPL, which does not only include loans to customers but also loans and advances to central banks and credit institutions, the Bank's NPL ratio was 2.3% at the end of 1H18 compared to 3.9% average for European banks.[2]

LOANS TO CUSTOMERS
Risk class and impairment stage. ISK bn
30.06.2018



LOANS TO CUSTOMERS: CREDIT QUALITY
Break-down of loans to customers

	Gross carrying amount		Impairment allowance		Net carrying amount	
	(ISK bn)	(% of portfolio)	(ISK bn)	(Imp. %)	(ISK bn)	(% of portfolio)
Stage 1	747	92.1%	2.8	0.4%	744	93.0%
Stage 2	40	5.0%	1.2	3.1%	39	4.9%
Stage 3	24	2.9%	7.0	29.6%	17	2.1%
Total	811	100.0%	11.1	1.4%	800	100.0%

1. The impairment allowance for 31.12.2017 is based on IAS 39 but other dates are based on IFRS 9
2. Source European Banking Authority

Liabilities

Diversified funding strategy

ISK m	**30.6.2018**	31.3.2018	31.12.2017
Deposits from CB and credit inst.	**15,391**	13,563	11,189
Deposits from customers	**578,414**	575,196	567,029
Derivatives and short positions	**7,075**	8,104	5,492
Debt issued and other borrowings	**288,360**	269,255	217,748
Subordinated loans	**8,872**	8,838	9,505
Tax liabilities	**8,925**	7,908	7,787
Other liabilities	**32,447**	39,028	35,947
Non-current liabilities held for sale	**76**	79	80
Total liabilities	**939,560**	921,971	854,777
Total equity	**172,182**	166,337	181,045
Total liabilities and equity	**1,111,742**	1,088,308	1,035,822

HIGHLIGHTS

Deposits

- Customer deposits are up by 2.0% to ISK 578bn in end June 2018
  - The increase was due mainly to an increase in pension fund positions but also from individuals and SMEs
- The deposit-to-loan ratio was 69.1%

Debt issued and other borrowings

- Includes covered bonds, commercial papers and bonds in foreign currency
- Market access for covered bonds remain solid, with issuance of ISK 13.0bn in the first half of 2018, reinforcing the Bank's position as Iceland's largest covered bond issuer

Other liabilities

- 75% of other liabilities are attributable to credit card liabilities to retailers through the Bank's subsidiary Borgun

Equity

- Íslandsbanki's dividend pay-out ratio target is 40-50% of after tax profits. Due to its strong capital position, a higher dividend payment of ISK 13bn was approved during its March Annual General Meeting (AGM), bringing the Bank's total dividend payments to ISK 76bn since 2013

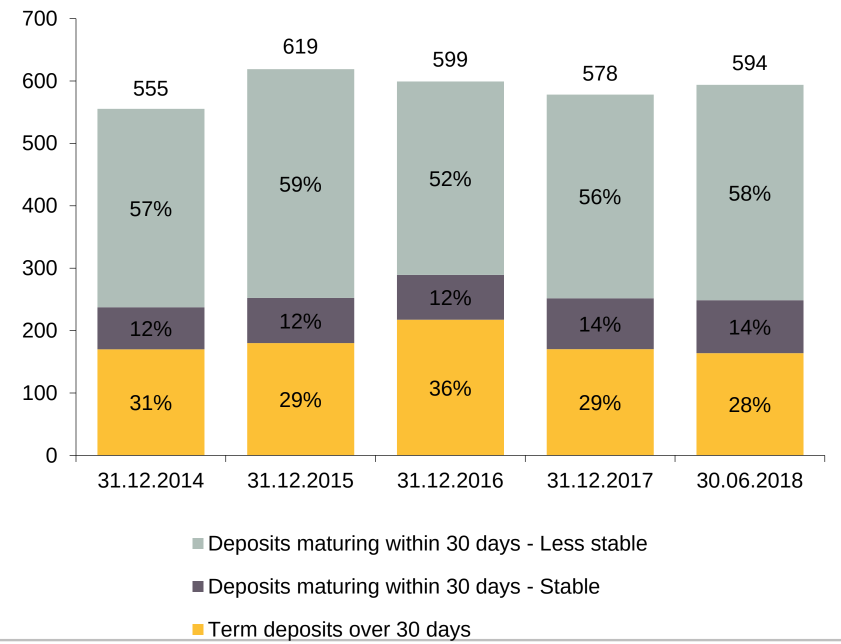
Deposits remain the main source of funding

Core deposits continue to be stable

DEPOSIT BY LCR CATEGORY
30.06.2018 compared with year end-2017, consolidated

ISK bn	Less stable	Δ	Stable	Δ	Term deposits	Δ	Total deposits	Δ
Retail	**126**	7	**67**	3	**67**	(2)	**260**	8
SMEs	**63**	7	**15**	0	**7**	0	**85**	7
Operational relationships	**2**	1	**-**	-	**-**	-	**2**	1
Corporations	**61**	(3)	**0**	(0)	**23**	(5)	**84**	(7)
Sovereigns, Central Bank and public sector entities	**8**	1	**0**	(0)	**1**	(1)	**9**	0
Financial institutions in composition	**2**	(1)	**-**	-	**-**	-	**2**	(1)
Pension funds	**43**	12	**-**	-	**28**	(1)	**71**	11
Domestic financial entities	**26**	(5)	**-**	-	**29**	2	**55**	(3)
Foreign financial entities	**1**	(3)	**-**	-	**7**	3	**9**	(1)
Other foreign entities	**12**	4	**2**	(0)	**3**	(3)	**17**	0
Total deposits	**345**	19	**85**	3	**164**	(6)	**594**	16

DEPOSIT COMPOSITION
ISK bn, consolidated



HIGHLIGHTS

Stable core deposit base

- Deposits remain the main funding source for the Bank and the deposit to loan ratio remains high
- At the end of the period, 73% of the deposits were in non-indexed ISK, 15% CPI linked and 12% in foreign currencies

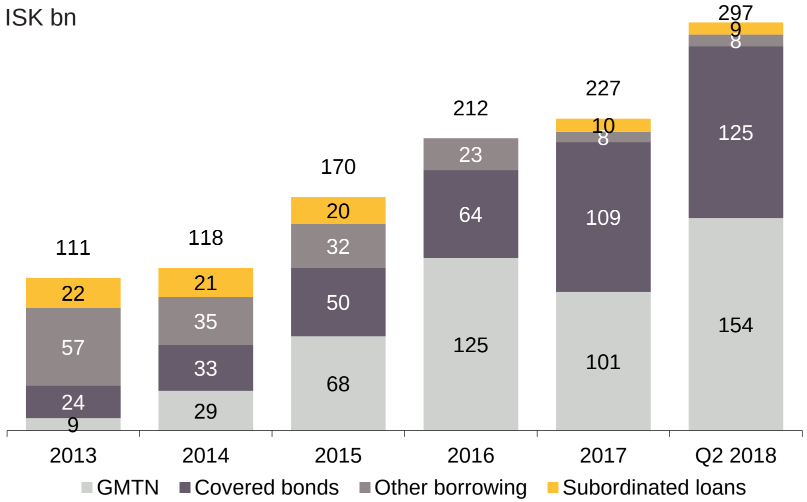
Deposits concentration remains stable

- At the end of June 2018,15% of the Bank's deposits belonged to the 10 largest depositors depositors and 37% belonged to the 100 largest depositors. Compared to 15% and 39% respectively for year-end 2016

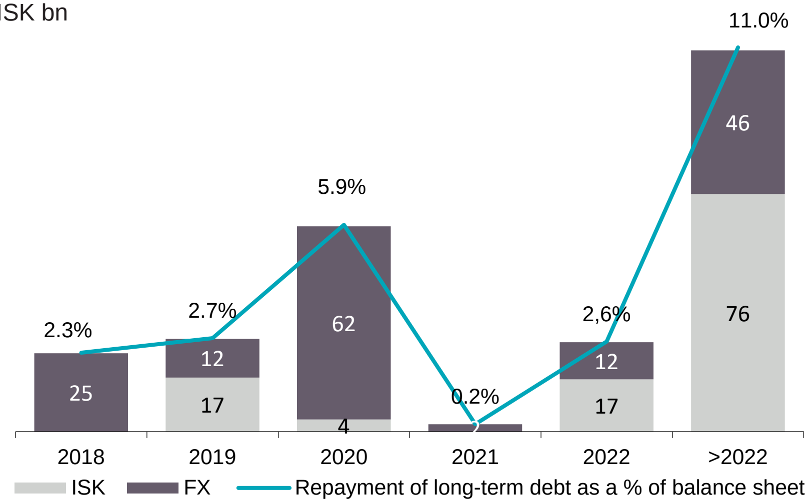
Borrowings

Successful international and domestic market transactions

BORROWING SOURCES
Book value
ISK bn



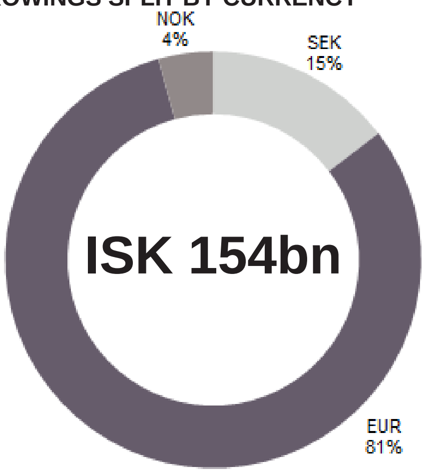
MATURITY PROFILE OF LONG-TERM DEBT
Nominal value
ISK bn



HIGHLIGHTS

- Íslandsbanki is the largest issuer of covered bonds in the domestic market
    - Total covered bonds issuance in Q2 was ISK 3.8bn
- Successful international funding in Q2
    - SEK 1bn issued in April 2018
    - In late June/early July 2018, the Bank issued three private placements, one SEK 300m, one SEK 350m and one SEK 100m, under its GMTN Programme

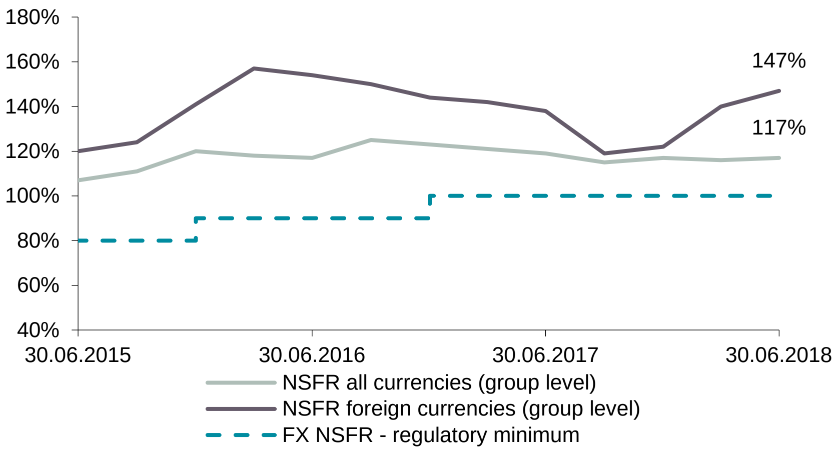
FX BORROWINGS SPLIT BY CURRENCY
%



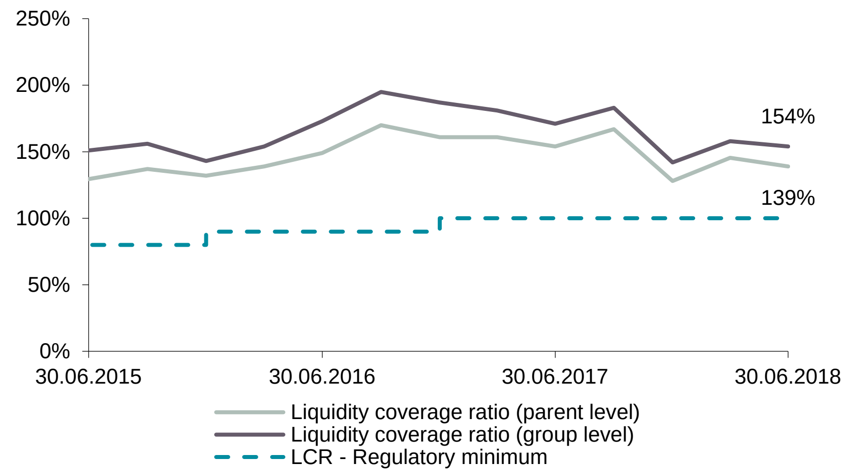
Sound management of liquidity

Liquid assets of ISK 243bn are prudently managed

NET STABLE FUNDING RATIO (NFSR)



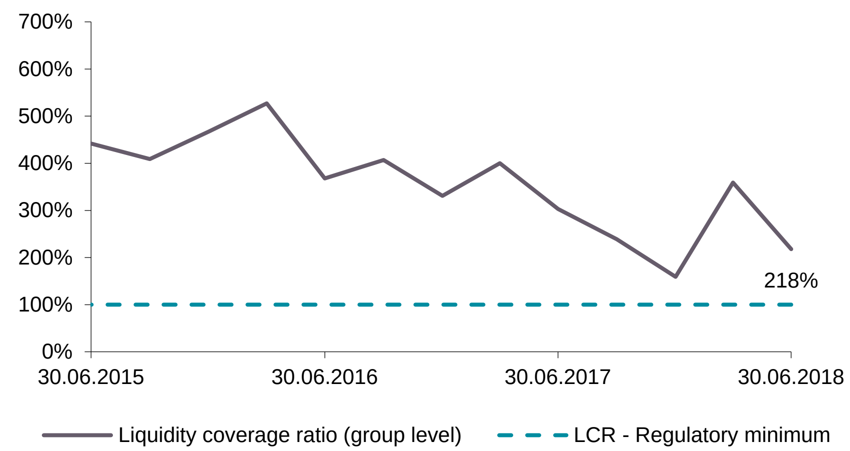
LIQUIDITY COVERAGE RATIO – ALL CURRENCIES



HIGHLIGHTS

- All liquidity measures well above regulatory requirements
- FX liquid assets are composed of government bonds that have a minimum requirement of AA rating and cash placed with highly rated correspondent banks
- Stress testing of liquidity position is an integrated part of the annual ICAAP/ILAAP process as well the annual regulatory stress test
- Liquidity Contingency Plan is in place which shall be tested regularly

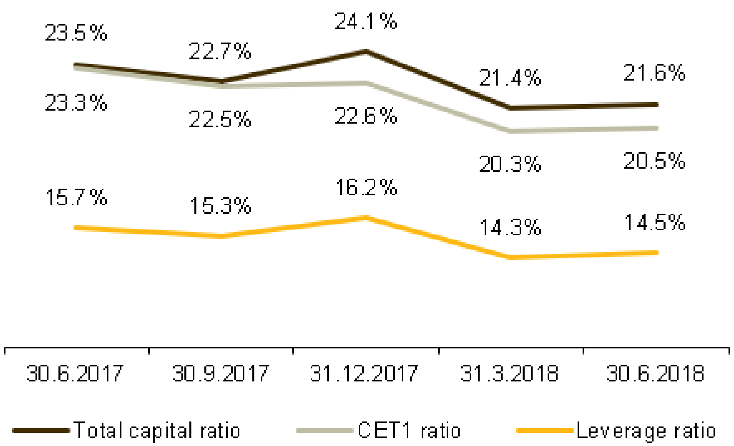
LIQUIDITY COVERAGE RATIO – FOREIGN CURRENCIES



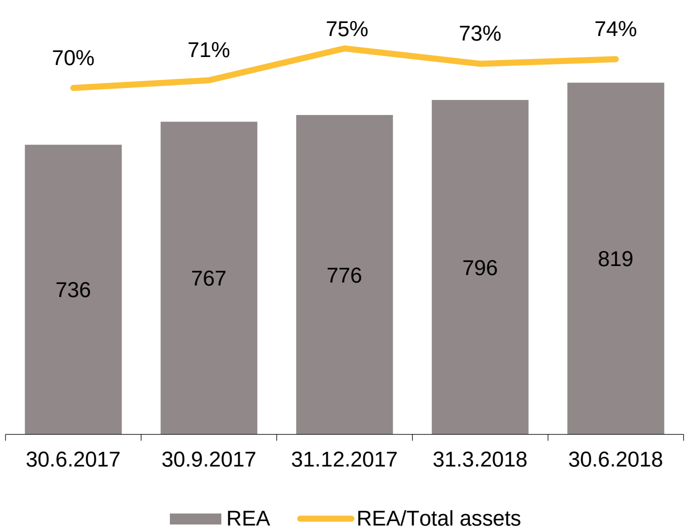
Sound capital position

The capital ratio in line with target and leverage is low

CAPITAL RATIOS



RISK EXPOSURE AMOUNT (REA)
ISK bn



HIGHLIGHTS

Capital ratios

- Capital base was ISK 176bhn at 30 June 2018, compared to ISK 187bn at year-end 2017
- The decrease is mainly due to an ISK 13bn dividend payment in March

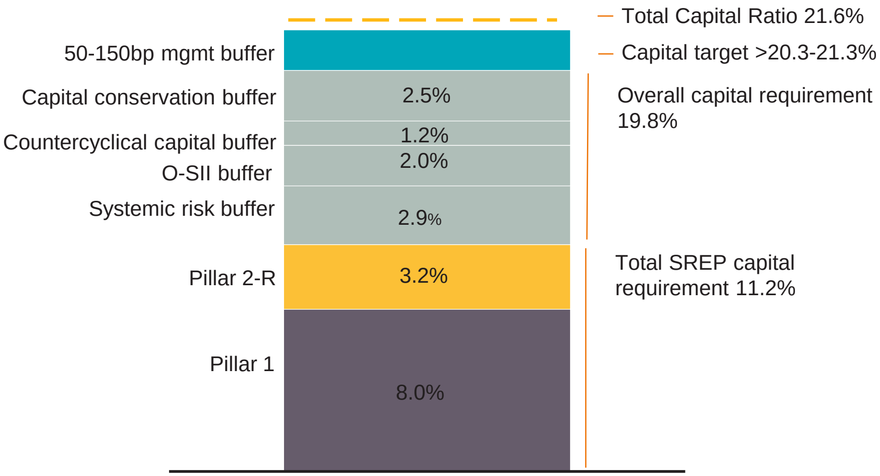
Risk exposure amount (REA)

- The REA increased by ISK 24bn during the quarter, mainly due to increase in loans to customers
- The ratio of REA of total assets decreased from 75% to 74%
- The decrease is mainly due to an increase in the Bank's liquidity portfolio which has a low risk weight

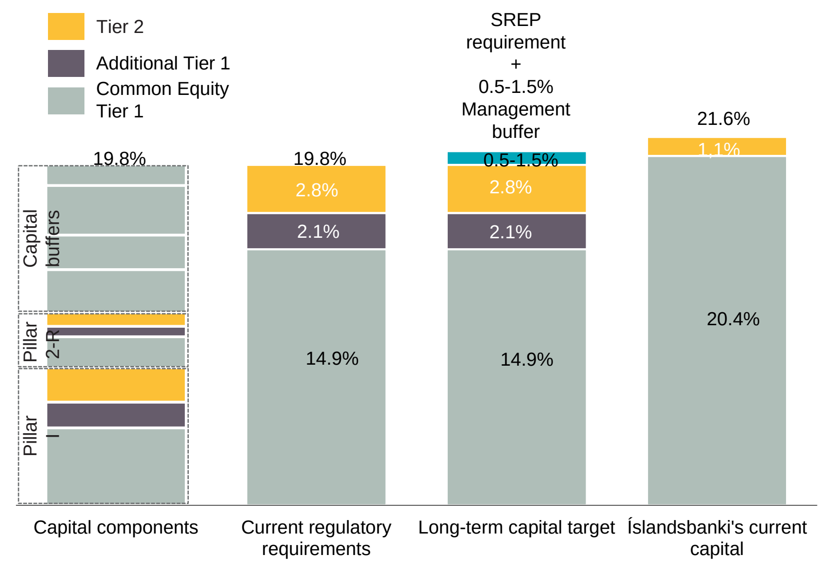
Íslandsbanki's capital target

Based on the regulatory SREP requirement in addition to 50 – 150bp management buffer

ÍSLANDSBANKI'S CAPITAL TARGET



CAPITAL REQUIREMENT COMPOSITION



HIGHLIGHTS

- The sum of Pillar 1, Pillar 2-R and the combined capital buffers form the overall regulatory capital requirement
- Based on the SREP 2017 results the overall capital requirement for Íslandsbanki is 19.8% of risk exposure amount (REA)
- The FME has increases the countercyclical capital buffer from 1.25% to 1.75%, effective from May 2019
- Íslandsbanki's total capital target ratio is based on the regulatory SREP requirement in addition to a 50-150bp management buffer
- The size of the management buffer is based on factors such as volatility in the capital ratios for example due to currency fluctuations, volatility in earnings and REA and uncertainties in the regulatory or operating environment

4. Financial targets and highlights

Financial targets

Medium and long term strategies structured around achieving key financial targets

	TARGET	1H18	2017	2016	Guidance
ROE REGULAR OPERATIONS[1]	8-10%	✓ **9.9%**	✓ 10.3%	✓ 10.7%	• Based on risk free rate + 4-6% • The risk free rate is considered to be CBI current account rate, currently at 4% (average in 2017 = 4.4%) • As the Bank retains a large pool of liquid assets, interest rate level in Iceland can have a substantial impact on ROE levels • The bank tax, excluded thus far from target returns, will have an impact on profitability if kept at current high levels
COST / INCOME RATIO[2]	<55%	**67.3%**	62.5%	56.9%	• This is a medium to long term target, C/I ratio can be expected to be higher than target in the near term • Headcount and non-headcount related cost control programmes in place • Lower C/I on parent company basis than on a consolidated basis
CET1	>15% LT	✓ **20.5%**	✓ 22.6%	✓ 24.9%	• Current SREP requirement plus management buffer means currently a minimum 15.4-16.4% CET1 ratio
TOTAL CAPITAL RATIO	> 20.3 – 21.3%	✓ **21.6%**	✓ 24.1%	✓ 25.2%	• Based on the regulatory SREP requirement with a 50 – 150bp management buffer • Current SREP requirement is 19.8% • Short term target removed in Q317 due to less uncertainty regarding lifting of capital controls and IFRS9 implementation
DIVIDEND PAYOUT RATIO	40-50%	**----**	✓ 100%	✓ 50%	• Dividend pay-out ability will be impacted if the bank tax will be kept at current high levels • The BoD agreed to pay out ISK 13 billion in dividend for the 2017 financial year which is higher than the dividend payout target due to a strong capital position

1. Return from regular operations on normalized CET1 of 15%, adjusted for risk free interest on excess capital. Results 2014-15 based on CET1 14%. Earnings from regular operations is defined as earnings excluding one-off items e.g. net loan impairment before collective impairment, fair value gain deriving from changes in accounting treatment, Bank tax, and one off costs

2. Calculated as (Administrative expenses + Contribution to the Depositors' and Investors' Guarantee Fund – One off items) / (Total operating income – one-off items)

Íslandsbanki highlights

Delivering responsible growth driven by the vision to be **#1 for service**

1 MACRO MILESTONES

Economy **stabilising** as pressure in key sectors eases, **growth slows**, debt ratios remain stable and ISK stays within a narrow range following the lifting of capital controls

2 CORE REVENUES

ROE of regular earnings normalised for 15% CET1 demonstrates the Bank's continued **solid business position,** recurring revenues, focus on efficiency, strong lending growth and **healthy profitability** against a firm capital base

3 BALANCE SHEET

Growing balance sheet, now at ISK 1,112bn, through balanced growth of loan portfolio of 5.6%, or ISK 98.5bn in **new lending** in 1H18 and **rise in deposits** from customers by 2% in 1H18 to ISK 578bn

4 FUNDING SUCCESS

Continued funding successes such as through **innovative callable features** in recent EUR 300m and SEK 1bn transactions while maintaining our status as a **leader in the domestic covered bond market**

5 CAPITAL & LIQUIDITY

Sound capital and liquidity ratios that compare very well with peers – 14.5% leverage ratio and **capital optimisation process** likely to continue with **additional Tier 1 or Tier 2** issuances in order to normalise the capital structure

6 STRATEGY

As part of our vision of being **#1 for service**, we are launching **new digital services**, revising core IT systems and opening up the Bank for third party cooperation in preparation for PSD2 while completing the move to our new HQs and introducing a new organisational structure

---

GDP growth
3.6% 2017

Net profit	7.1bn
ROE (Regular operations)	9.9%
Capital Ratio	21.4%
Loan growth	5.6%

ROE after tax
8.2%

BBB / BBB+
ratings

LCR	154%
NFSR	147%
Leverage ratio	14.5%

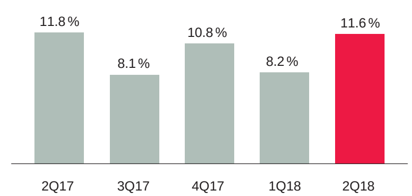
ÍSLENSKA ÁNÆGJUVOGIN
EUROMONEY 2013-2016, 2018
The Banker Bank of the year 2014, 2016, 2017 ICELAND

Information above is based on the Bank's 1H18 financial results and forecasts by Íslandsbanki Research

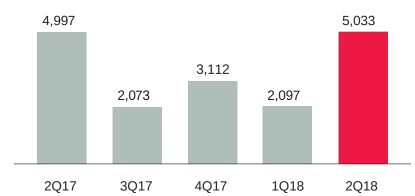
Financial highlights

Key figures

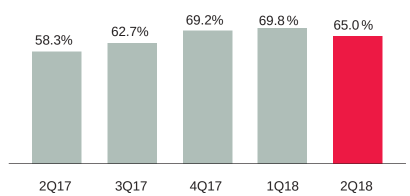
ROE reg. operations CET1 15%[1]



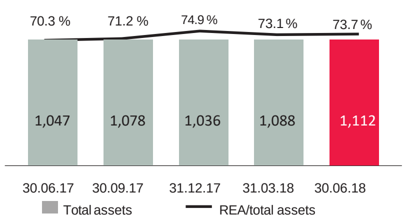
Profit after tax
(ISKm)



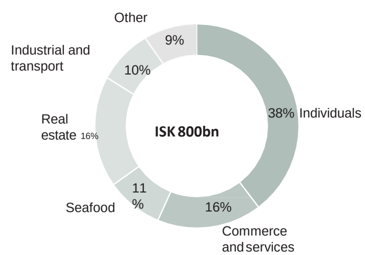
Cost / income ratio [2]



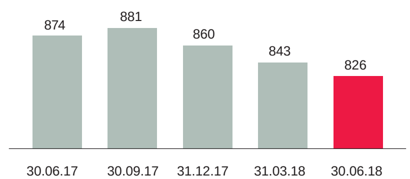
REA / total assets
(ISKbn)



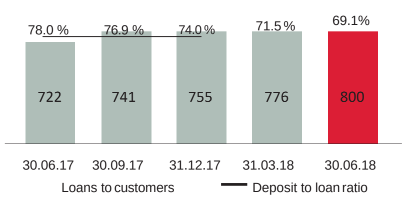
Loans to customers – sector split
As of 31.3.18



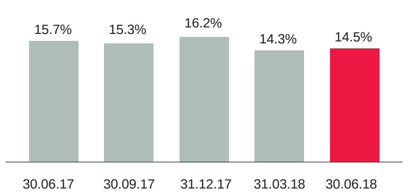
Number of FTEs for Parent Company
Excluding seasonal employees



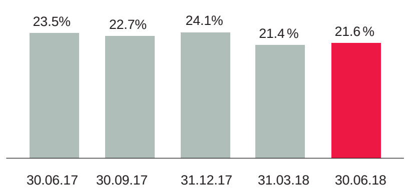
Loans to customers
(ISKbn)



Leverage ratio



Total capital ratio



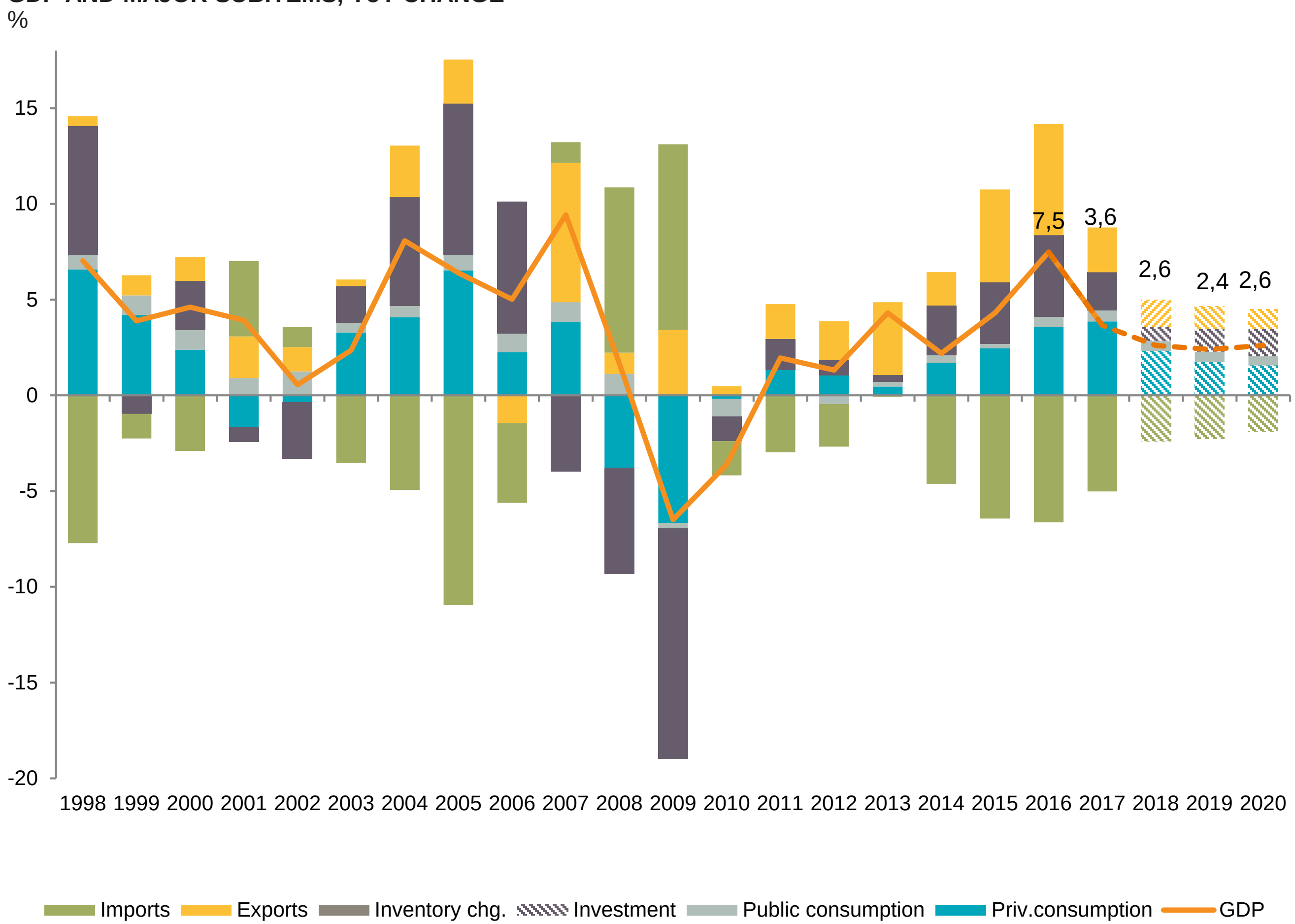
1. Earnings on regular income now includes profit from discontinued operations.
2. The cost / income ratio for the parent company is 57.6%

Annex - Icelandic economy update

Economy moving towards equilibrium

Households and public sector increasingly main drivers of growth

GDP AND MAJOR SUBITEMS, YoY CHANGE[1]



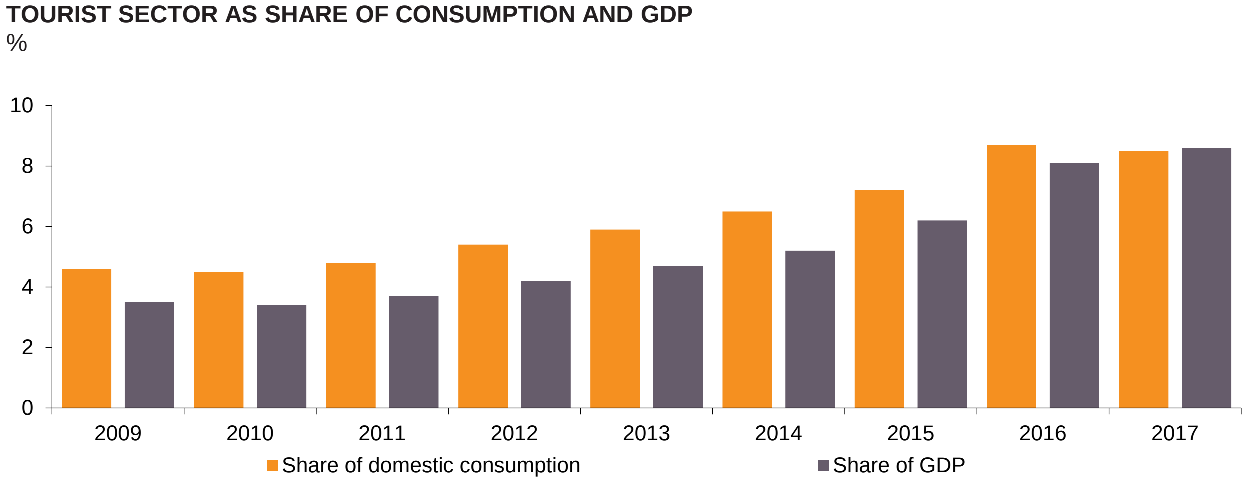
- After a period of rapid GDP growth in the middle of the decade, the business cycle is on the decline
- GDP growth driven increasingly by households and the public sector rather than businesses
- Íslandsbanki research projects output growth at 2.6% this year, 2.4% in 2019, and 2.6% again in 2020
- The pace of growth will be close to potential, and the output gap will narrow steadily
- The economy is moving towards greater equilibrium by various measures
- A relatively soft landing is likely to follow Iceland's long, steep upward cycle

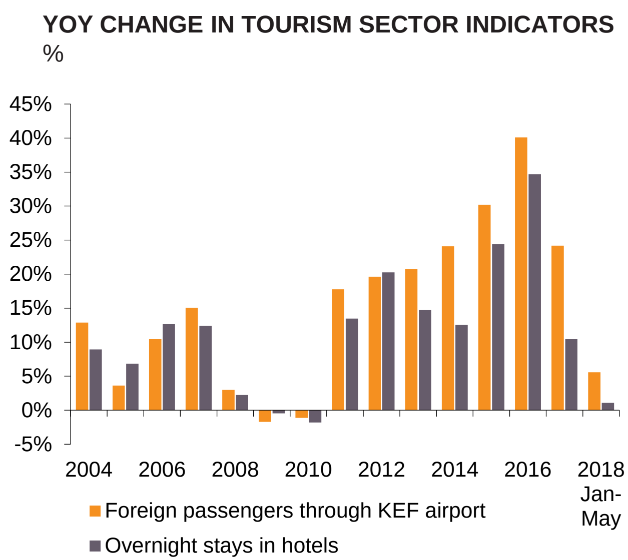
Source: Statistic Iceland, Central Bank of Iceland, IMF and ISB Research

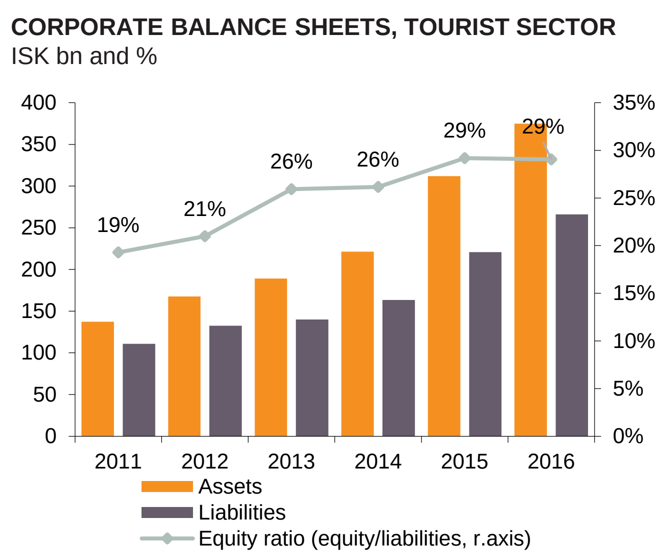
1. Shaded areas indicate ISB Research/IMF forecasts

Tourism sector maturing

Growth in 2018 has been the slowest since 2010







- Growth in tourism has slowed markedly, after the boom of the past few years
- In 2017, the number of tourists visiting Iceland increased 24% year-on-year. Services exports grew by 8.1%, less than half of he 2015-2016 average
- Tourism-related activity accounted for 8.6% of GDP in 2017 while 8.5% of domestic consumption was due to tourism
- In the first 5 months of 2018, the number of foreign passengers through KEF airport grew by 5.6%, the slowest growth since 2010
- The outlook is for tourism to continue to be the mainstay of export growth. We estimate that over ¾ of export growth will come from increased services exports
- Equity ratios in the tourism sector have increased despite rapid growth and large investments

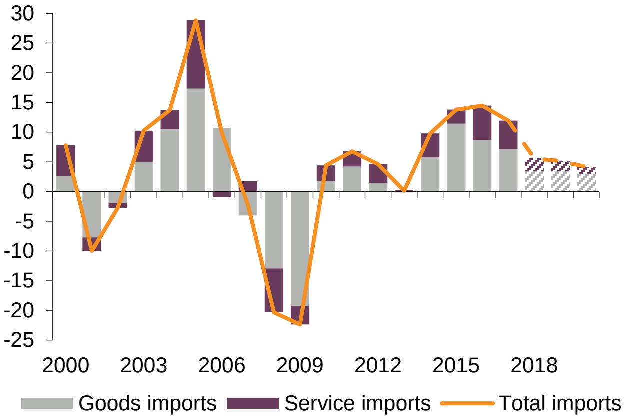
Source: Iceland Tourist Board, Statistics Iceland and ISB Research

1. Shaded areas indicate ISB Research/IMF forecasts

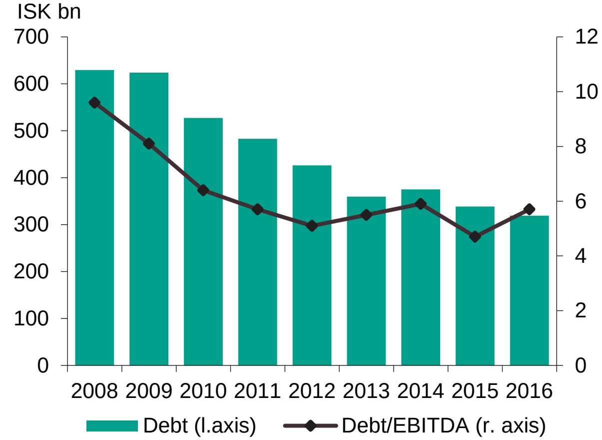
Moderate goods exports growth ahead

Fishing industry debt ratios stable

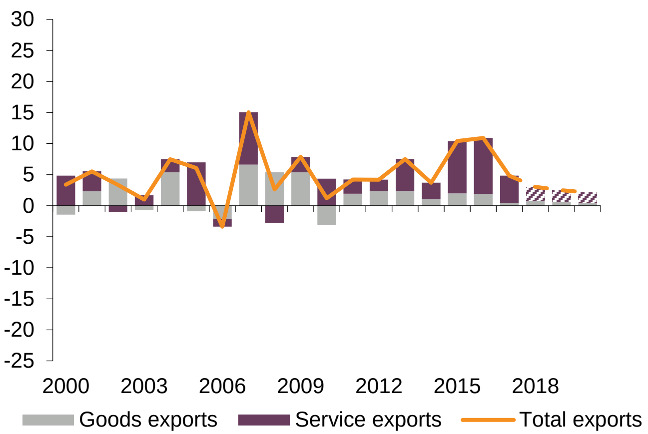
IMPORTS¹
YoY real % change



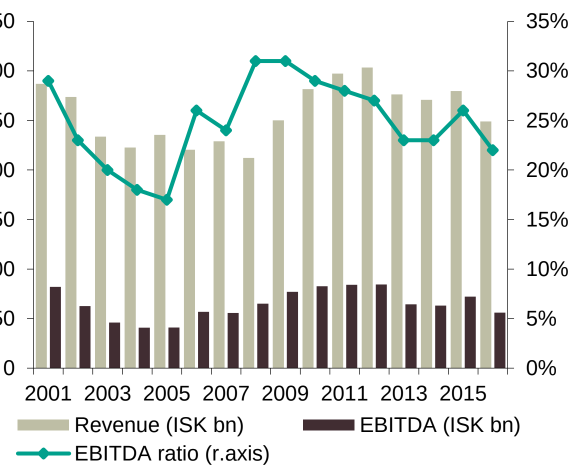
FISHING COMPANIES' DEBT POSITION



EXPORTS¹
YoY real % change



FISHING INDUSTRY REVENUES AND EBITDA



- Outlook for moderate growth in goods exports in the next few years
- Marine product exports are the main factor here, owing to increased quotas for cod and other ground fish
- On the imports side, increased goods imports will account for some 2/3 of total imports
- The increase in goods imports is due to growth in domestic demand — not least in private consumption and residential investment — and also importation of inputs for tourism and other export sectors
- Debt levels of the fishing industry have stabilized in recent quarters following a broad decline in 2010-2013

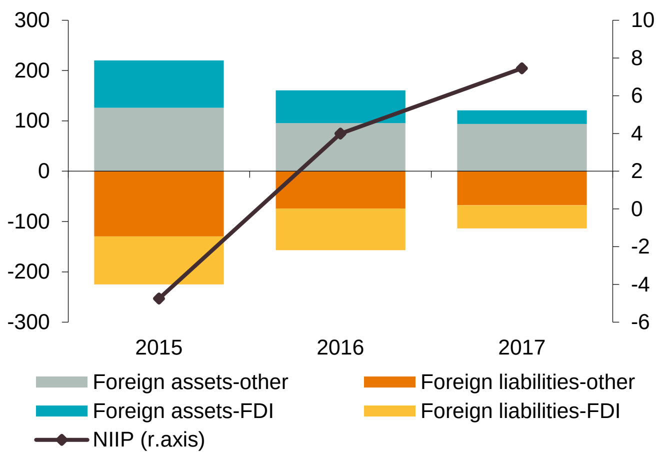
Source: Iceland Tourist Board, Statistics Iceland and ISB Research

1. Shaded areas indicate ISB Research/IMF forecasts

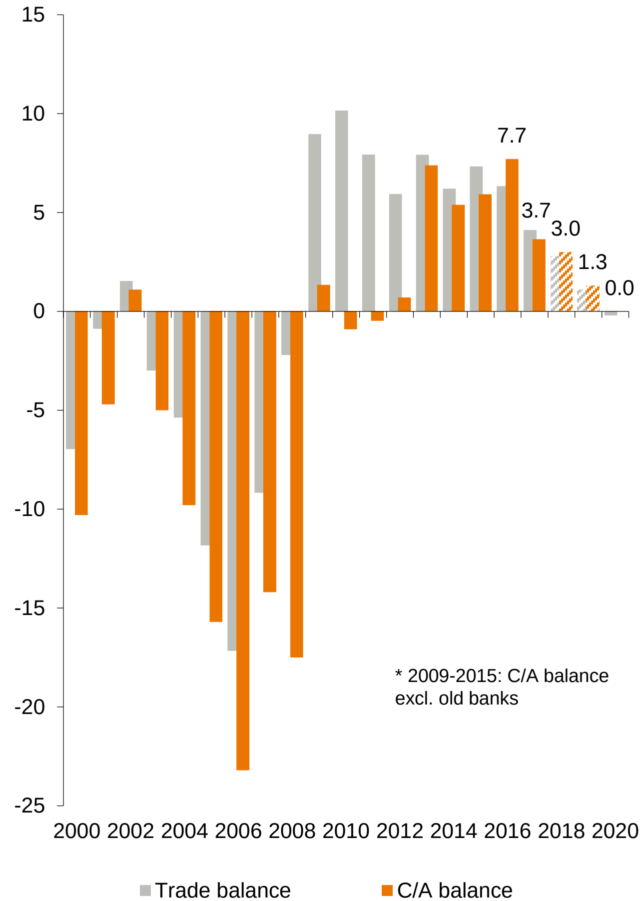
Current account surplus narrowing

Ongoing moderate growth in tourism key to continued C/A surplus

INTERNATIONAL INVESTMENT POSITION[1]
% of GDP



CURRENT ACCOUNT BALANCE[1]
% of GDP



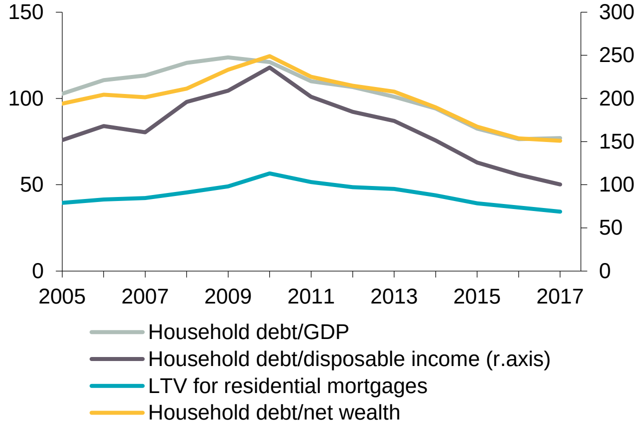
- The current account surplus narrowed to 3.7% of GDP in 2017 following four years of substantial surplus
- The outlook is for a high real exchange rate to cause the surplus to diminish steadily over the forecast horizon
- However, there are few indications that it will turn sharply negative in the next few years, provided that the real exchange rate does not rise too steeply from the current value and terms of trade do not deteriorate excessively
- Iceland's positive international investment position (IIP) has led to increased tolerance to a higher real exchange rate as net financial income should generally have a positive impact on the current account balance
- The outlook is for the IIP to remain positive

Source: Statistics Iceland, Central Bank of Iceland and ISB Research
1. Shaded areas indicate ISB Research forecasts

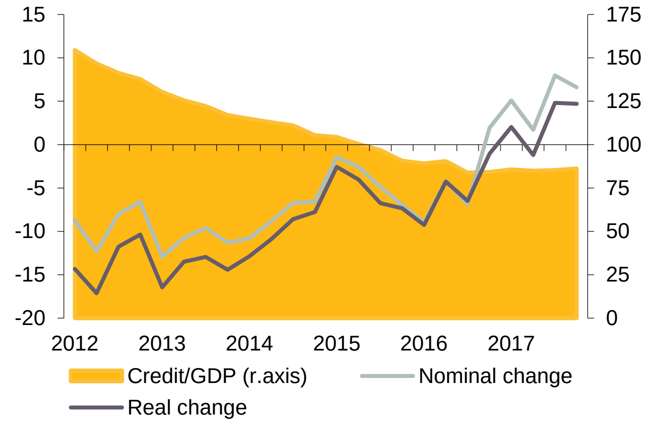
Domestic balance sheets healthy

Debt ratios stable following substantial deleveraging

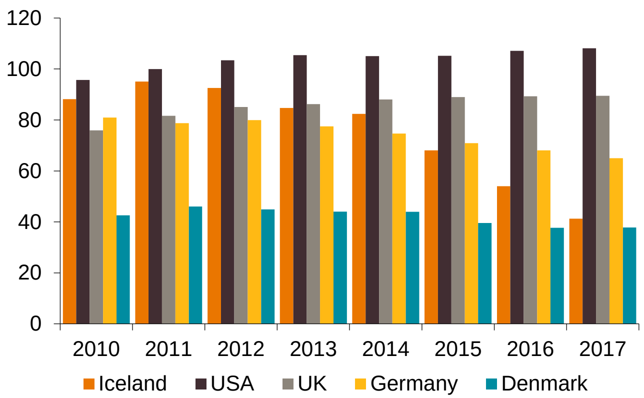
HOUSEHOLD DEBT
%



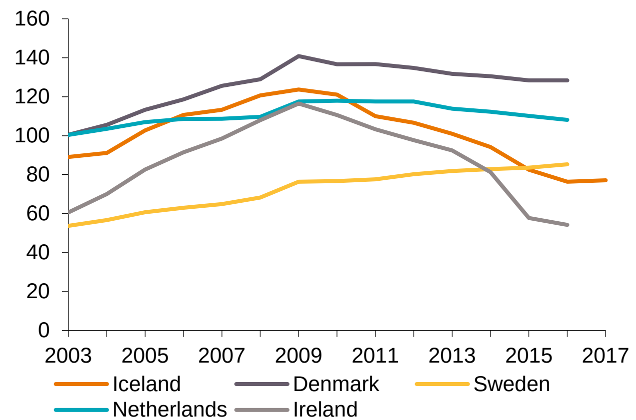
CORPORATE CREDIT AND CREDIT GROWTH
% of GDP



CENTRAL GOVERNMENT GROSS DEBT
% of GDP



HOUSEHOLD DEBT
% of GDP



- Gross central government debt has decreased from 88% of GDP to 41% of GDP over the past 7 years
- Private sector credit-to-GDP ratio has decreased considerably in the past decade due to deleveraging and, more recently, also robust GDP growth
- In recent years, corporate investment has largely been financed by equity, but the share of credit financing is growing
- Corporate credit fell from 155% of GDP in 2012 to 84% of GDP by mid-2016. Credit growth has picked up in recent quarters but has mostly remained in step with nominal GDP growth
- Average LTV ratio of residential real estate has fallen from 55% in 2010 to around 34% by end-2017 due to a combination of deleveraging and rising house prices

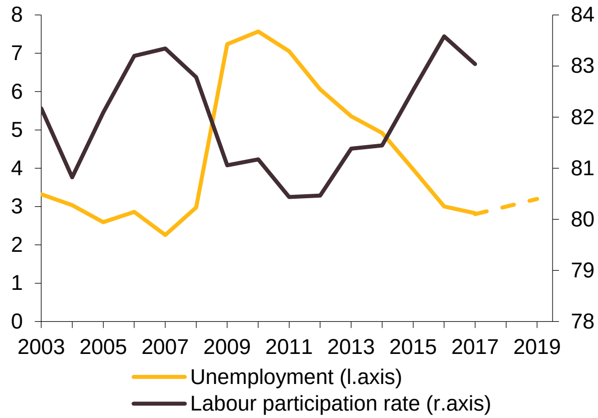
Source: The World Bank, The Central Bank of Iceland, Statistics Iceland

Favourable conditions for households

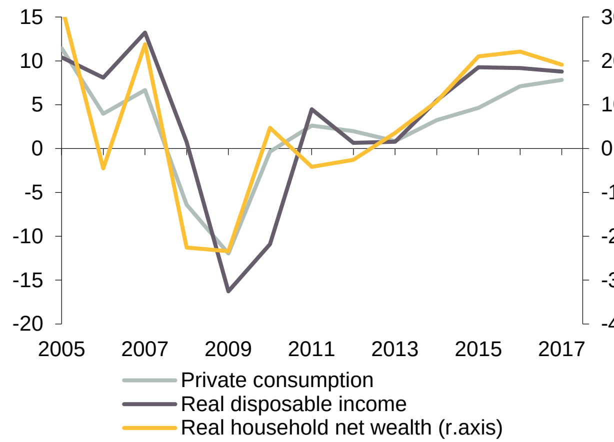
Rising net wealth and real wages support continuing increase in consumption

- Demand pressures in the labour market peaked in 2017 at 2.8% unemployment
- Real wage growth peaked in 2016, at 9.5%, and then retreated to 5.0% in 2017
- The outlook is for wages to rise slower and inflation to be higher than in recent years., resulting in slower real wage growth
- We project real wage growth at 3.2% this year, and 1.8% in 2019, and 1.7% in 2020
- Private consumption growth peaked last year at 7.8% in real terms
- There are however no signs that increased consumption has been debt-financed to any marked degree
- ÍSB Research projects private consumption growth at 4.6% this year, 3.4% in 2019, and 3.0% in 2020

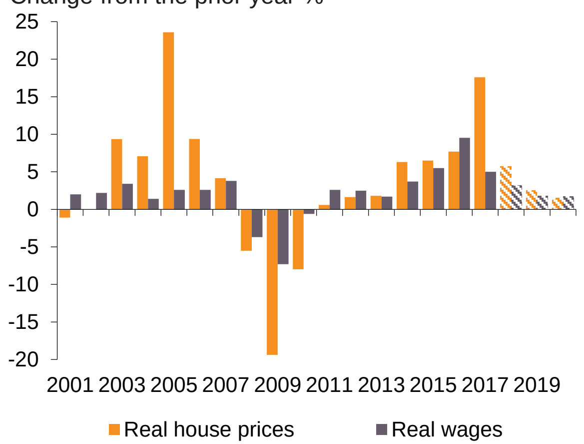
UNEMPLOYMENT AND LABOUR PARTICIPATION[1]
% of workforce



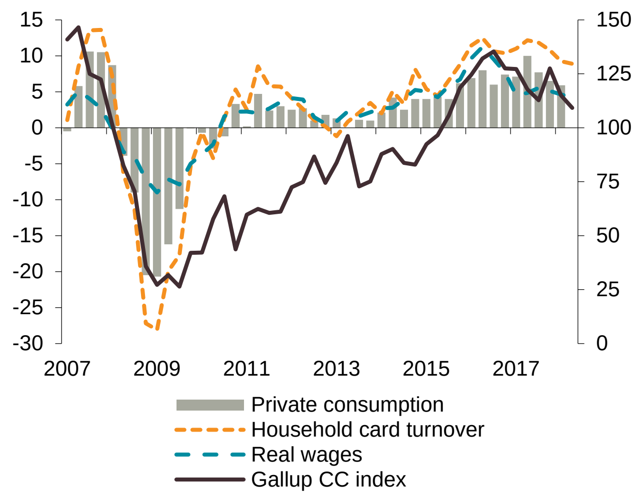
HOUSEHOLDS' WAGES, WEALTH & CONSUMPTION
Change from prior year %



REAL HOUSE PRICES AND REAL WAGES[1]
Change from the prior year %



PRIVATE CONSUMPTION AND RELATED INDICATORS
Real YoY change (l.axis) and index (r.axis)



Sources: Statistics Iceland, Central Bank of Iceland, ISB Research forecasts

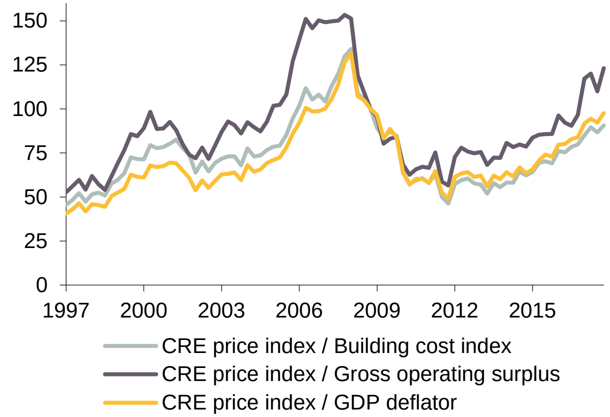
1. Shaded areas/dotted lines indicate ISB Research forecasts

Real estate market cooling

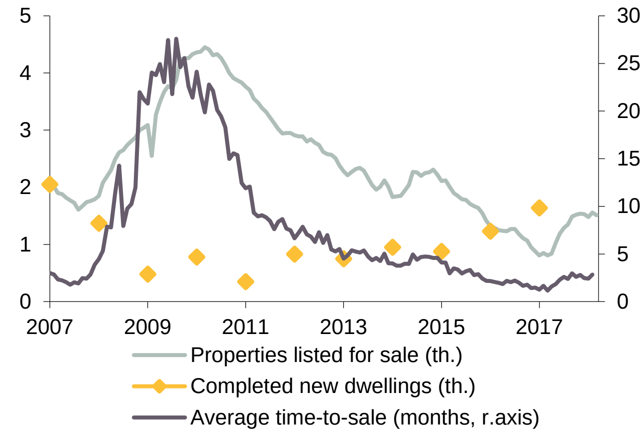
Price rises and turnover in the residential housing market are moderating

- The housing market is gradually normalising following a period of excess demand and rapid price rises
- House price inflation is easing after a steep rise in 2017 due to rapid real wage growth demographically induced demand pressures and lack of supply
- Demand will remain robust as demographic trends continue and real wages keep rising
- On the other hand, the supply of new flats is growing swiftly, and the imbalance between supply and demand is therefore narrowing steadily
- In the next two years, residential investment could account for about the same percentage of total investment growth as business and public investment combined
- Real house prices are expected to rise in coming years, albeit more slowly than in recent quarters

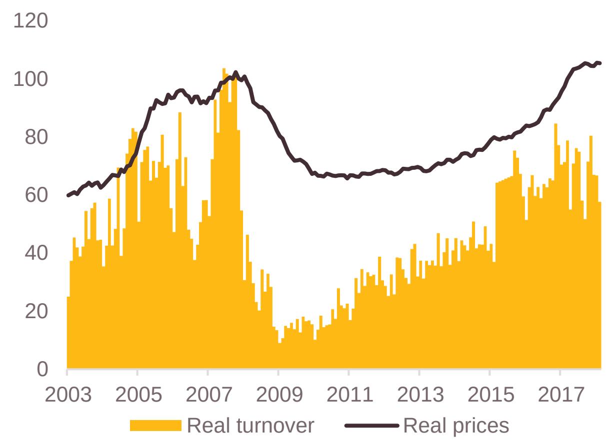
COMMERCIAL REAL ESTATE PRICE RATIOS
Index, Q4 2008=100



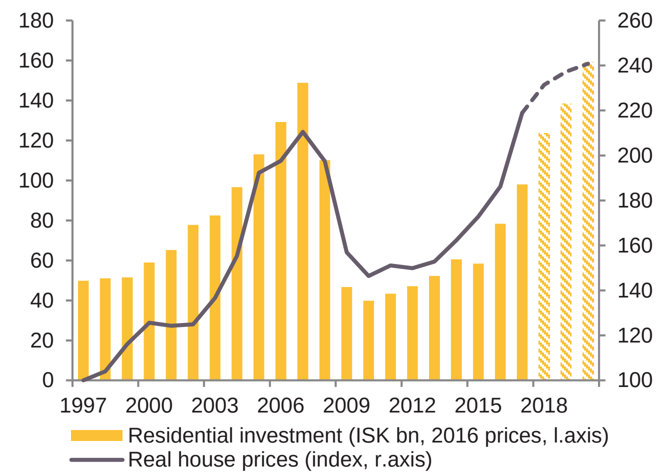
LISTED PROPERTIES, AVERAGE TIME TO SALE AND NEW CONSTRUCTION



REAL HOUSE PRICES AND TURNOVER
Index, Sep-07=100



HOUSE PRICES AND RESIDENTIAL INVESTMENT[1]



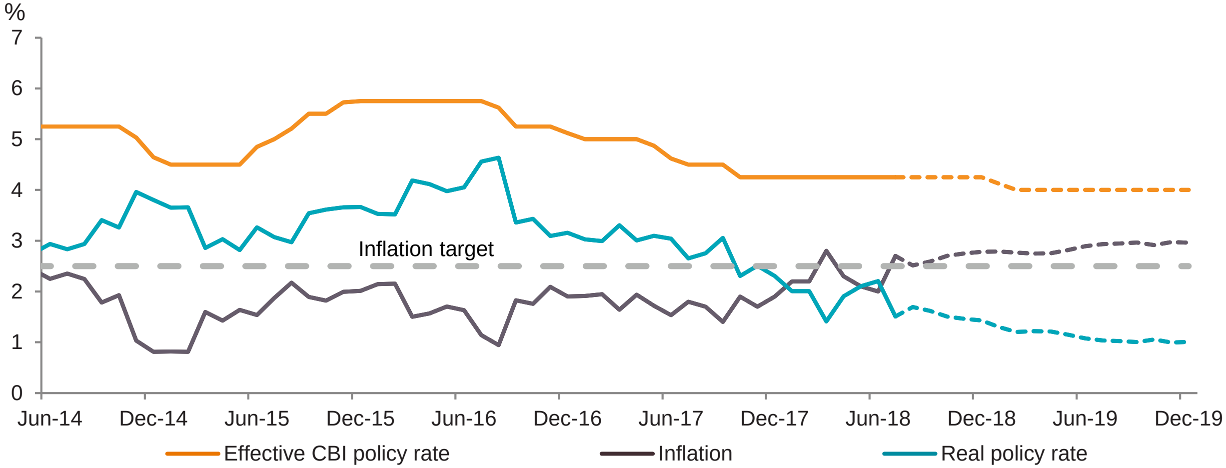
Sources: Statistics Iceland, Central Bank of Iceland, ISB Research forecasts

1. Shaded areas/dotted lines indicate ISB Research forecasts

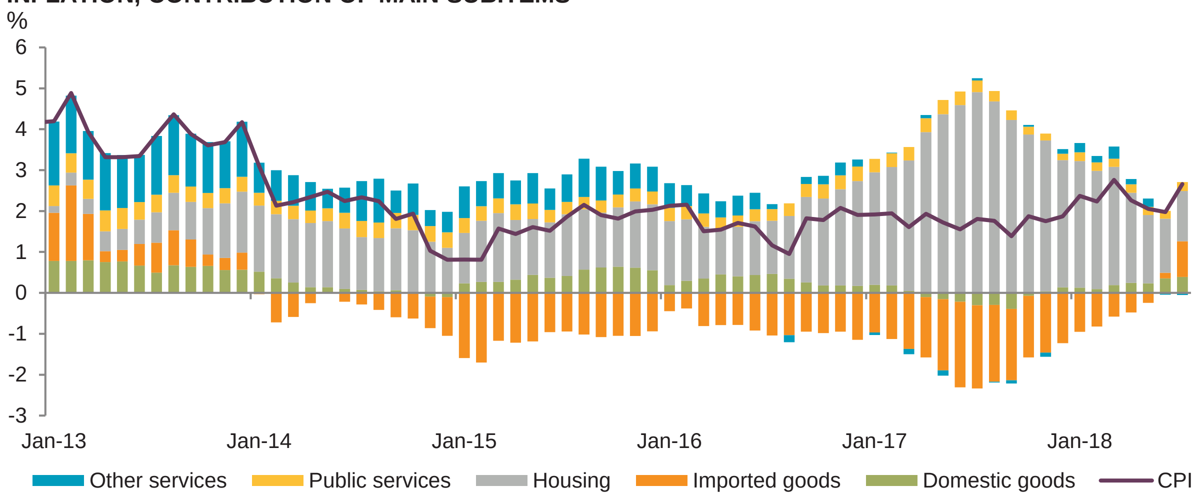
Inflation back at CBI's target

Interest rates likely to remain close to current levels

INFLATION, POLICY RATE AND REAL POLICY RATE[1]



INFLATION, CONTRIBUTION OF MAIN SUBITEMS



Sources: Statistics Iceland, Central Bank of Iceland, ISB Research forecasts

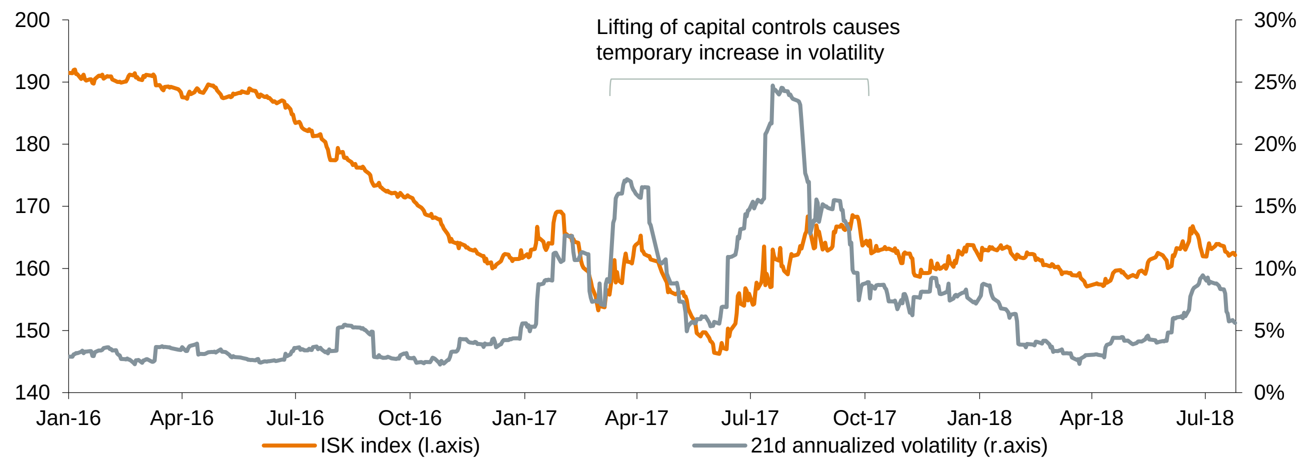
1. Shaded areas/dotted lines indicate ISB Research forecasts

- Following four years of inflation below the CBI's 2.5% target, inflation has been close to the target in recent months
- House prices remain the main contributor to inflation, although their impact is gradually decreasing
- Imported goods no longer exert downward pressure on prices as ISK has remained broadly stable since Q3 2017
- Inflation expected to be close to the CBI's 2.5% inflation target throughout 2018 and 2019
- Stable inflation and moderate inflation expectations have enabled the Central Bank to lower the policy rate in spite of demand pressures in the economy
- Interest rates likely to stay close to current levels as moderately rising inflation is offset by narrowing output gap in coming quarters
- Upside risk to inflation from upcoming wage bargaining round in the private sector

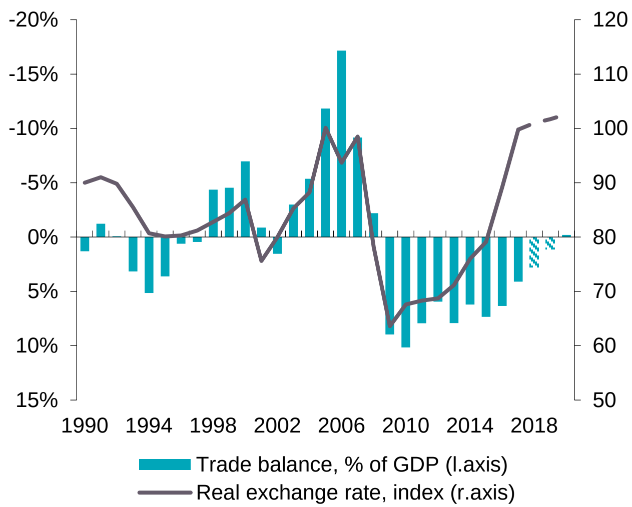
One year of relatively stable ISK

Rangebound exchange rate and moderate volatility since Q3 2017

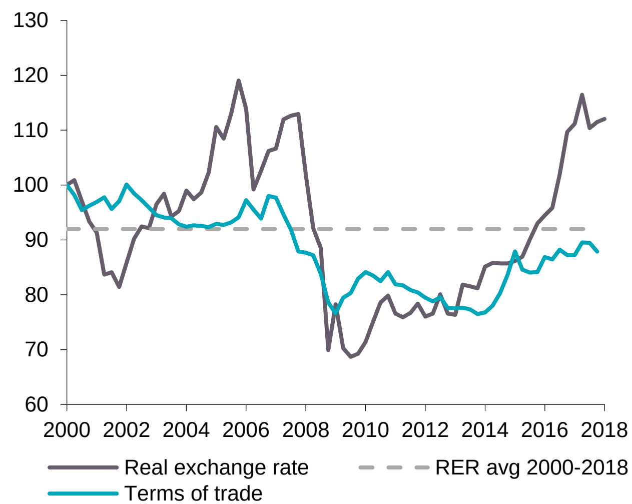
ISK TRADE-WEIGHTED INDEX AND VOLATILITY



TRADE BALANCE AND ISK REAL EXCHANGE RATE[1]



ISK REAL EXCHANGE RATE AND TERMS OF TRADE



- Since August 2017 the ISK has been relatively stable after a period of increased volatility around the lifting of capital controls
- The ISK has fluctuated within a 7% range since August 2017 and volatility has subsided despite a mostly free capital account and almost no CBI interventions
- A stable ISK is a sign of a successful capital account liberalisation process in H1 2017 and a relatively healthy balance in foreign currency inflows and outflows
- The exchange rate forecast to hold broadly steady in 2018-2020, at roughly the 2017 average
- Relatively balanced C/A, improved external position sustained interest in inward investments support high real exchange rate, but need for diversification by institutional investors an offsetting factor

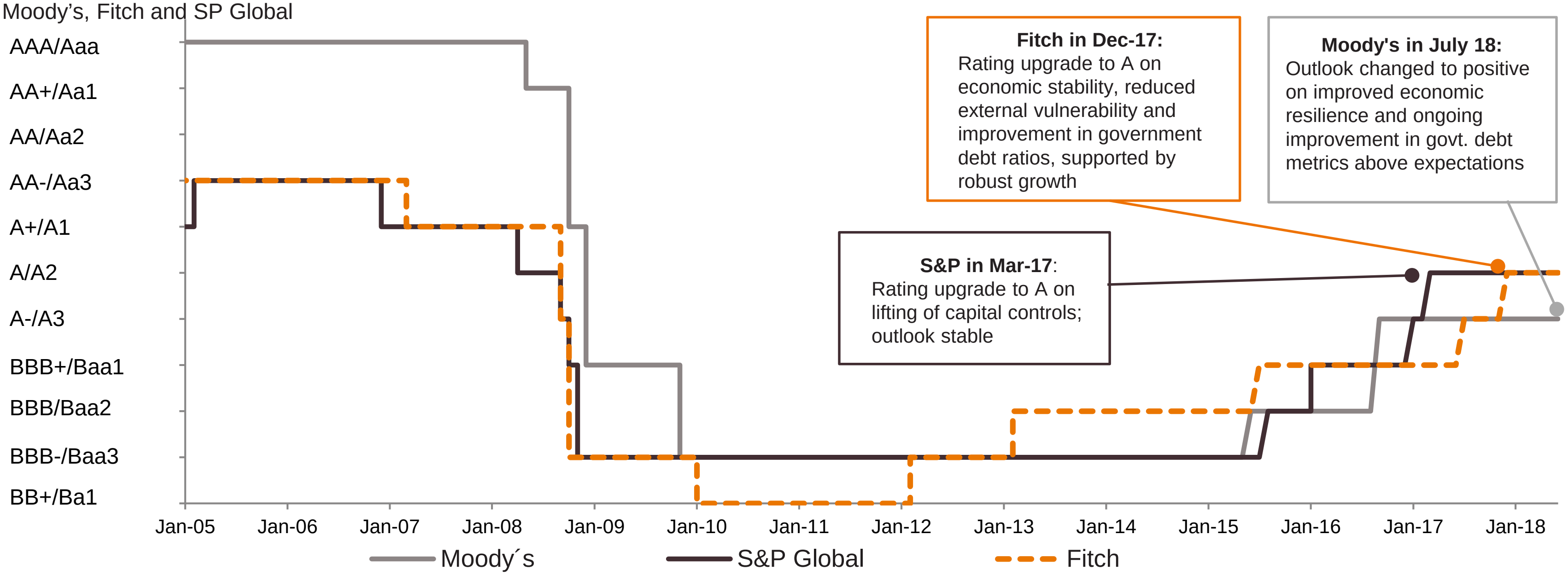
Sources: Statistics Iceland, Central Bank of Iceland, ISB Research forecasts

1. Shaded areas/dotted lines indicate ISB Research forecasts

Iceland’s credit rating on upward trajectory

Upgrades from S&P and Fitch following lifting of capital controls

DEVELOPMENT OF SOVEREIGN CREDIT RATING
Moody’s, Fitch and SP Global



MOODY’S IN JULY 2018

- The positive outlook also reflects progress made in the past two years on the major preconditions we laid out at the time of the upgrade to A3 in September 2016, including the smooth removal of capital controls and the settlement of the offshore krónur situation

FITCH IN JUNE 2018

- The outlook is stable
- The A rating balances the economy’s high income per capita, strong performance on governance, human development and doing business indicators against its high commodity export dependence, vulnerability to external shocks and experience of macroeconomic and financial volatility

S&P IN JUNE 2018

- S&P Global Ratings affirmed its 'A/A-1' long- and short-term foreign and local currency sovereign credit ratings on the Republic of Iceland. The outlook is stable
- The stable outlook balances the risks stemming from the domestic economy overheating against the potential for more rapid improvements in the government and external balance sheets over the next few years

Source: Moody's, S&P, Fitch Ratings and Central Bank of Iceland

Íslandsbanki credit ratings

Ratings affirmed from both S&P and Fitch in late 2017 and mid-2018

FITCH

BBB/F3 STABLE OUTLOOK

Press Release 15 December 2017

- In December, Fitch Ratings **affirmed** Íslandsbanki's ratings of **BBB/F3** with a **stable outlook**. Fitch had in January 2017, upgraded the Bank to this rating
- According to Fitch, the ratings for Íslandsbanki reflect the Bank's **leading domestic position** with a market share of around 30 per cent and the Bank's **satisfactory asset quality, stable liquidity position and high reported capital ratios**
- Furthermore, Fitch noted that Íslandsbanki's strategy to target **continued organic growth in Iceland**, combined with its **sound risk management framework**, would continue to strengthen the Bank's **asset quality**, with the Bank having seen a sharp **decline in its non-performing loans since 2010**

S&P

BBB+/A-2 STABLE OUTLOOK

Press Release 17 July 2018

- In July, S&P Global Ratings **affirmed** Íslandsbanki's ratings of **BBB+/A-2** with a **stable outlook** along with three other Icelandic financial institutions. S&P had in October 2017 upgraded the Bank to this rating
- In its press release, S&P notes that the rating actions take into account their view that **economic growth in Iceland continues to support the banking sector, resulting in business growth and low default rates**. This is balanced by their expectation of more challenging competitive and funding dynamics
- S&P also comments that the stable outlook on Íslandsbanki reflects our expectation that the **bank's RAC ratio will remain sustainably above 15%,** even while the bank prepares for an eventual sale or IPO over the next two years, and it optimises its capital base by paying extraordinary dividends and issuing capital instruments

ÍSLANDSBANKI	S&P	FITCH
Long-term	BBB+	BBB
Short-term	A-2	F3
Outlook	Stable	Stable
Rating action	July 18	Dec 17

ICELANDIC SOVEREIGN

	S&P	FITCH	MOODY'S
Long-term	A	A	A3
Short-term	A-1	F1	-
Outlook	Stable	Stable	Positive
Rating action	Jun 18	Jun 18	Jul 18

Rating reports and press releases can be found on the IR website: islandsbanki.is/IR

More about Íslandsbanki

Learn more about the Bank on the Investor Relations website and through our contacts

Investor material

- Further investor information can be found at the Íslandsbanki IR website: https://www.islandsbanki.is/english/investor-relations/
- Please visit the Icelandic IR site for material in Icelandic: https://www.islandsbanki.is/um-islandsbanka/fjarfestatengsl/

Investor relations

Gunnar S. Magnússon
Head of Investor Relations

Tel: +354 440 4665/ +354 844 4665
gunnarsm@islandsbanki.is

Media relations

Edda Hermannsdóttir
Executive Director and Head of Communications

Tel: +354 440 4005/ +354 844 4005
edda.hermannsdottir@islandsbanki.is

Forward Looking Statements

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